CURRENTS

WESTERN CANADA'S ECONOMIC BULLETIN

CanadaWest FOUNDATION

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→ VALUE-ADDED IN THE OIL PATCH → REFINERY CONSOLIDATION → AN ENERGY STRATEGY

Monthly Highlights

Goods Production Falters

Following a series of small monthly gains, the Canadian economy contracted in August as real GDP fell by 0.1%. The decline was concentrated in goods-producing industries which dropped by 0.5%, while services industries remained generally flat.

The Canadian goods-producing sector has not performed well in recent months, led by a number of western Canada's most important industries. In particular, oil and gas extraction has been weak through the summer and there has been a significant downturn in potash mining since May. August also saw setbacks in durable goods manufacturing, retail trade and public administration. Partially offsetting these losses was growth in agriculture, forestry and wholesale trade.

Like the economy in general, Canadian labour markets have been sluggish so far this year. From January through October, national employment is just 1.0% higher compared to the same period in 2011, not enough to absorb the growth in the national working-age population. As a result, the national unemployment rate has been slowly rising since about March.

The situation is somewhat better in the West where Alberta (2.8%), Saskatchewan (1.9%) and BC (1.8%) are creating jobs at a faster rate than elsewhere in Canada. Manitoba, however, has seen employment grow by just 0.7% through the first 10 months of the year.

On the bright side, tepid labour markets have not dampened wage growth. Average weekly earnings growth has accelerated across Canada since the spring, led by Saskatchewan where wages continue to increase at twice the national average rate.

Monthly Economic Statistics	BC	AB	SK	MB	Canada	Reference Month
Labour Markets						
Employment (000s)	2,317	2,161	541	628	17,568	October
% change from previous month	-0.5	0.2	0.4	-1.1	0.0	
Unemployment rate (%)	6.7	4.5	4.7	5.6	7.4	October
change in percentage points from previous month	-0.3	0.1	0.0	0.6	0.0	
Participation rate (%)	65.0	73.1	69.6	68.9	66.8	October
Average weekly earnings ($)	870.85	1,084.26	938.57	838.12	907.19	August
% change from previous month	-0.3	-0.4	1.2	0.6	0.4	
Inflation						
Consumer Price Index (% change from Sept 2011)	0.7	1.4	1.2	1.6	1.2	September
Economic Activity						
Retail trade ($M)	5,046	5,765	1,482	1,385	39,069	August
% change from previous month	-0.9	0.4	0.6	-0.4	0.3	
Wholesale trade ($M)	4,607	6,548	1,818	1,306	49,665	August
% change from previous month	1.5	0.1	-6.2	1.1	0.5	
Manufacturing sales ($M)	3,243	6,208	1,210	1,266	49,461	August
% change from previous month	1.3	0.5	0.8	-4.7	1.5	

Unless otherwise noted, data are seasonally adjusted.
Source: Statistics Canada.

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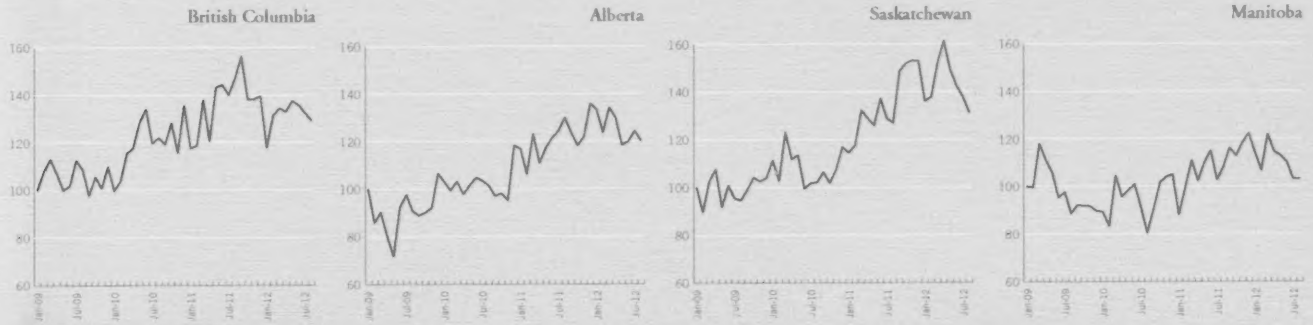
INTERNATIONAL MERCHANDISE EXPORTS (INDEX: JAN 2009 = 100)

Source: Canada West Foundation calculations using Statistics Canada data.



Monthly Feature

Oil Production & Refining in Western Canada

The recent addition of new upgrading and refining capacity in Alberta and Saskatchewan will help increase the amount of value-added activity that takes place in the region's oil and gas industry. Despite the increase in capacity, a significant share of the region's crude oil and raw bitumen continues to be transported out of the region unprocessed.

Upgraders are facilities that convert raw bitumen into lighter "synthetic" crude oil, making it ready for use in refineries (some upgraders are also able to produce final products such as diesel fuel). There are currently five upgraders operating in western Canada, all in Alberta. These upgraders have enough capacity to handle about 1.3 million barrels per day (bbl/d) of bitumen, equivalent to a little more than half of current oil sands output. Remarkably, even though upgrading capacity has increased by about 125% since 2002, raw bitumen production has increased even faster. There is more raw bitumen being shipped out of Alberta today than ever before.

Western Canada is also home to eight operating refineries: three each in Alberta and Saskatchewan and two in BC. Being larger on average, Alberta's refineries accounted for 62% of the West's total refining capacity in 2011. Most of Canada's refineries, however, are located outside the region, closer to major markets for petroleum products. The eight facilities in the West accounted for about 37% of national refining capacity (not including upgraders) in 2011.

While western Canada has far less refining capacity than the eastern provinces, the gap is narrowing. As expansion projects have increased capacity in the West, poor market conditions have kept eastern refineries running at well below optimal levels, prompting some facilities to close down. From 2001 to 2011, refining capacity in the West increased by 33% while it decreased by 5% in the East.

Because the jump in capacity has not kept pace with oil production, there has been no noticeable uptick in the proportion of western Canadian oil that is processed within the region. Data for 2011 suggest that western Canada's refineries could accept about 41% of local supply – an improvement over a decade ago (36%), but lower than in the mid-2000s and early 1990s.

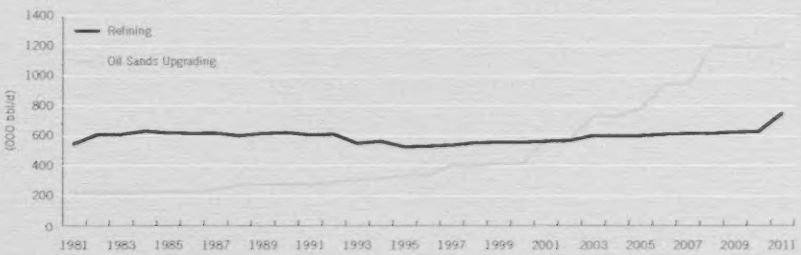
However, the recent completion of a $2.7-billion expansion to the Regina Co-op Refinery Complex will allow more crude oil to be processed locally. That facility can now accept 45% more crude oil, making it the second largest refinery in western Canada and the fourth largest in the country.

This expansion should also help improve western Canada's trade balance in refined petroleum. Perhaps surprising given the amount of crude oil produced in the region, western Canada is a net importer of refined petroleum products such as gasoline. In 2011, refined petroleum exports from the four provinces were valued at $1.7 billion, while imports were worth nearly $5.9 billion. All four provinces were net importers that year, including Alberta which is buying significant volumes of light hydrocarbons from the US, which are used to dilute the raw bitumen that is exported out of the province.

$4.2B

Western Canada's trade deficit in refined petroleum products in 2011.

REFINING & UPGRADING CAPACITY IN WESTERN CANADA



Source: Canadian Association of Petroleum Producers.

DID YOU KNOW?

Manitoba has been quietly enjoying a mini-boom in oil production. While total volumes remain just a fraction of output levels in neighbouring Saskatchewan, crude oil production in Manitoba has risen by 267% since 2001. Manitoba has passed BC to become Canada's fourth-largest oil-producing province.

Western Canada's largest oil refinery, located just east of Edmonton, has an estimated capacity of about 190,000 bbl/d. However, this facility is only about two thirds the size of Canada's largest refinery located in Saint John, New Brunswick.

So far in 2012, the West's trade deficit in refined petroleum is widening beyond last year's record levels. From January through August, the western provinces were net importers of $3.4 billion of refined petroleum, an increase of 26% compared to the same period last year.

BEHIND THE NUMBERS

Refinery Consolidation in the West

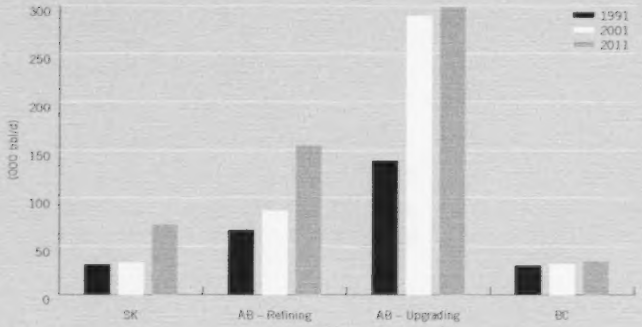
Reflecting a global trend, the refining industry in the West is consolidating, resulting in fewer but larger facilities.

Increased global competition and tight margins have led oil refinery operators to seek out economies of scale in production by shutting small and unprofitable facilities while expanding and modernizing others. In the early 1980s, there were 19 refineries and upgraders operating in the West, with an average capacity of about 40,000 bbl/d each. By 2011, the number of working plants had fallen to 12 but their average capacity had risen to 162,000 bbl/d.

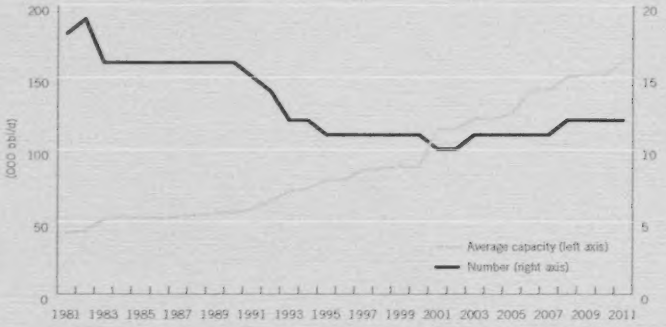
This consolidation process has dramatically reduced refining capacity in western Canada's bookend provinces. Manitoba's only refinery closed in 1982, while the number operating in BC fell from seven to two. Unlike Saskatchewan and Alberta, however, there has been only minimal expansion of BC's remaining facilities; since the last closure in 1995, average refining capacity in BC is up by just 15%.

1984
the last year a new refinery was built in western Canada.

AVERAGE CAPACITY OF REFINERIES BY PROVINCE



NUMBER & SIZE OF OPERATING REFINERIES IN WESTERN CANADA



Source: CWF calculations using CAPP data.
Note: Includes both refineries and upgraders.

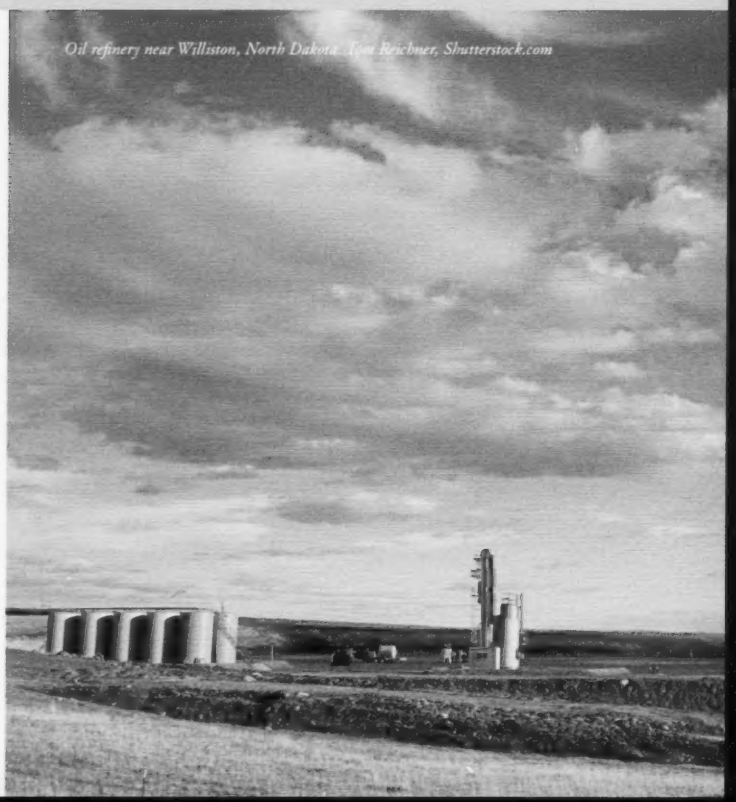
Energy Focus: Alberta

Challenging Oil Sands Economics

Suncor's plan to build a 200,000 bbl/d upgrader in Ft. McMurray is the latest in a series of ambitious projects to be put on hold in Alberta. While the $11.6-billion investment has not yet officially been suspended, the company has suggested that it may no longer be economically viable.

A major factor behind this more negative outlook has been the rapid growth in unconventional oil production in the United States, notably from the Bakken play in North Dakota. The oil produced from the Bakken formation is less costly to extract and is more desirable to many US refineries because they are better equipped to handle the lighter crude found in the Bakken.

This preference for lighter crude, combined with existing pipeline capacity constraints, is contributing to the gap between western Canadian crude prices and benchmark rates – an added concern given that western Canadian oil projects generally have a higher-than-average breakeven price.



Oil refinery near Williston, North Dakota. Tom Reichner, Shutterstock.com

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OPINION

BY ROBERT ROACH, VICE PRESIDENT OF RESEARCH

Laying our Cards on the Table: Canada's Strategic Energy Priorities

With the exception of BC's Christy Clark, Canada's premiers recently agreed to create a new Canadian energy strategy that will update the strategy they developed in 2007 enitled *A Shared Vision for Energy in Canada*.

This raises a basic question: what is the purpose of a new Canadian energy strategy?

The answer is simple: to maximize the benefits of Canada's energy resources.

This means selling as much of our energy as we can at the highest possible price (something we are falling well short of right now) while maintaining an efficient, reliable and affordable domestic energy system to meet the demands of Canadian industry and consumers.

Achieving this depends mostly on the entrepreneurialism, hard work and ingenuity of the private sector, but it is naïve to think that governments do not have a role to play and even more naïve to think that Canada will reach its energy potential if those governments don't find ways to work together.

The dust up between BC and Alberta over the Northern Gateway pipeline highlights the value of proactively hammering out common objectives and tradeoffs rather than trying to address issues as they arise.

Our friends in Asia must be scratching their heads wondering what is going on. On the one hand, we have a Prime Minister saying that access to Asian markets is critical. On the other hand, we have the Premier of BC threatening to stymie the export of oil from Alberta while planning to sell Asia gas found in northeastern BC.

A Canadian energy strategy will not resolve every potential conflict, but surely we can do better than this state of confusion?

With that said, it is important to stress that not everyone is going to get what they want from a Canadian energy strategy. It can't be all things to all people.

Given this, what should a new Canadian energy strategy focus on?

First and foremost, we need to secure markets for our energy exports. We need to work tirelessly to convince our US cousins to buy our energy while building lasting relationships with potential Asian customers to ensure that we have a range of export options. This will enable us to get top dollar for our energy exports and avoid putting all our energy eggs in the US basket.

We also have to expand – and quickly before someone else scoops up our potential customers – the pipes, transmission lines and port facilities that transport our energy products to market. There is no question that we must address the environmental impacts and risks of this infrastructure but if we put our minds to it, we can.

Second, we need to identify the energy needs of Canadians over the next 50 years and work backward from this to figure out what has to be done to meet these needs. Again, the private sector will do the heavy lifting, but governments have a role to play developing and coordinating policies that will facilitate private enterprise.

From environmental regulation and labour shortages to foreign investment and international agreements, governments need to *work together* to provide the energy sector and consumers with a logical public policy context.

This does not mean that provincial differences and experimentation will disappear. The different parts of Canada need to add their unique strategies to the overall approach. It may not even be possible to get all ten provinces, the three territories and Ottawa to agree on a meaningful strategy that goes beyond platitudes about balancing energy and the environment.

But even if the effort falls short, forcing ourselves to think strategically will reveal common ground and energize (pun intended) regional cooperation. We at least owe it to ourselves to try.

The Canada West Foundation is developing a western Canadian energy strategy this fall to complement the efforts to draft a Canadian energy strategy.

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